



# Tax News Flash

## - Customs

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Samjong KPMG provides readers Customs related recent local issues and trends. This newsletter is a monthly publication of Samjong KPMG. If you need more detailed explanation, please feel free to contact Key contacts.



The following is a recent Customs-related Court case in Korea

### 1. Whether the amount of the TP adjustment in questions fall under the definition of “subsequent proceeds” as defined in Article 30 (1) (5) of the Customs Act [Supreme Court, 2022du35275]

Under the Customs Act, **“Subsequent proceeds”** is one of the additions from the customs perspective, similar to the additions to taxable income in corporate tax, which is defined as “the amount of proceed derived from the sale, disposal, or use of the imported goods after the importation of such goods, which is directly or indirectly attributable to the seller”. Recently, the issue of subsequent proceeds went to the Supreme Court and the taxpayer won the case, thus we would like to introduce it as follows.

#### 1) Fact

According to the supply contract between the plaintiff and the exporter (“HQ”), the import price that the plaintiff imports from the HQ is based on the HQ’s standard cost multiplied by a premium rate. However, by comparing the actual operating profit achieved by the plaintiff with the target operating profit corresponding to the arm’s length price, if the actual operating profit exceeds the target operating profit, the excess amount will be remitted to the HQ, and if the actual operating profit falls short of the target operating profit, the deficiency amount will be received from the HQ (hereinafter referred to as the “TP adjustment”).

The Plaintiff imported health food products from the HQ (hereinafter referred to as the 'goods in questions'), declared the customs value of the goods in question as the HQ's standard cost multiplied by the premium rate, paid customs duties accordingly, and paid a certain amount of TP adjustment in some months. (Hereinafter referred to as the "TP adjustment in questions")

The defendant believed that the TP adjustment constituted "subsequent proceeds" as defined in Article 30 (1) (5) of the Customs Act, as the amount of proceed derived from the sale of the goods in questions were paid back to the HQ. In response, the defendant issued a notice of taxation by reassessing the customs value by adding the amount of the TP adjustment in questions to the customs value of the goods in question.

## **2) Issue**

Whether the amount of the TP adjustment in questions fall under the definition of "subsequent proceeds" as defined in Article 30 (1) (5) of the Customs Act

## **3) Decision**

The Court noted that in order for a payment to be included in the customs value as subsequent proceeds under Article 30(1)(5) of the Customs Act, i) it must be an amount directly related to the imported goods out of the sales proceeds obtained from the sale of the imported goods, and ii) such amount must be calculable based on objective and quantifiable data, and concluded that the amount of the TP adjustment in question could not be defined as "subsequent proceeds" under the Customs Act for the following reasons.

**While corporate tax has the objective of preventing taxpayers from intentionally transferring income abroad and fairly distributing taxable income without double taxation, customs duties aim to determine the customs value of individual goods and to impose duties in line with the value of the goods at the time of importation. Therefore, in essence, whether the amount of TP adjustment made to converge to the arm's length range for tax purposes, can be included as additions in the customs value should be determined depending on the actual cause and nature of the payment.**

The amount of the TP adjustment is the portion of the excess of the target operating profit rate and is not the sum of the individual profit amounts calculated for each imported goods, and the operating profit rate, which is the basis for the TP adjustment, is calculated by deducted Cost of goods sold (COGS) and SG&A expenses from the gross profit multiplied by the selling price and sales volume. It means that since operating profit rate is affected not only by the selling price but also by various factors such as sales volume, premium rate, fluctuations in exchange rates, and SG&A expenses, it is difficult to consider that the amount of TP adjustment as an adjustment to the price of the imported goods.

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The defendant argues that the amount of the TP adjustment in questions constitutes the amount of proceeds from the sale of the goods in questions, which is directly or indirectly attributable to the HQ, because the plaintiff set a lower premium rate compared to the increase in its operating profit rate, resulting in the goods in question at a lower price and the payment of the TP adjustment. However, **considering that the plaintiff continuously increased the premium rate over the standard cost and the COGS as a percentage of sales increased year after year, while the operating profit rate before adjustment remained unchanged, the Court held that the COGS, including the import price, could not be considered the most important factor affecting the amount of TP adjustment.**

In addition, the amount of the TP adjustment added by the defendant to the customs value cannot be regarded as adding only the amount directly related to individual imported goods to the customs value based on objective and quantifiable data.

#### **4) KPMG's comment**

The above court case lays down the general principle based on the principle of substantive taxation that whether the amount of TP adjustment is included in the customs value as an addition to the customs value as subsequent proceeds, should be determined by distinguishing the actual cause and nature of the TP adjustment, specific requirements for conclusion of the TP adjustment amounts as subsequent proceeds include: i) it must be an amount directly related to the imported goods out of the sales proceeds obtained from the sale of the imported goods, and ii) such amount must be calculable based on objective and quantifiable data.

As Korean multinational corporations often make TP adjustments between related parties, it is necessary to identify the substance and nature of such TP adjustment amounts to determine whether they constitute subsequent proceeds under the Customs Act. The occurrence of TP adjustment amounts can be caused by a combination of various factors, such as the increase or decrease in sales price or volume, the increase or decrease in operating expenses such as labour costs, and price discount policies, etc. **It is important to mention that it is recommended to review by professionals if applicable, whether the amount of TP adjustment can be shown that the TP adjustment was not caused by a lower import price, especially for the companies that are scheduled for future customs audits or the companies that have already been imposed customs duties on similar issues.**



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